In the Supreme Court of the United States

October Term A.D. 1940

No.

NORTHWESTERN BREWERS SUPPLY COMPANY, and STURDY-BILT EQUIPMENT CORPORATION,

Petitioners,

vs.

WILLIAM J. SCHMIT, Trustee,

Respondent.

In the Matter of DELTA BREWING COMPANY, a Corporation,

Bankrupt.

BRIEF IN SUPPORT OF PETITION

OPINIONS BELOW

The District Court rendered an opinion not reported (R. 110).

The opinion of the Circuit Court of Appeals is short and unsupported by statute or decisions and not reported (R. 135).

JURISDICTION

The decree of the Circuit Court of Appeals sought to be reviewed was entered on January 14, 1941. Motion for rehearing was denied on February 12, 1941. Stay of mandate was granted on March 4, 1941.

The jurisdiction of this Court is invoked under the Bankruptcy Act, Sec 24c, 11 U.S.C.A. 47(c), and the Judicial Code, Sec. 240, 28 U.S.C.A. 347(a).

STATEMENT OF FACTS

The facts have been stated in the petition.

SPECIFICATIONS OF ERRORS

It is submitted that the Court below erred:

1. In ruling that a petition for reclamation or a claim for priority as secured creditors was necessary prior to a sale free and clear, to preserve lienors' rights.

2. In affirming the order of the lower court confirming the sale free and clear of encumbrances.

SUMMARY OF ARGUMENT

The Court below refused to disturb an order confirming a Trustee's sale of property free and clear from liens having a value of approximately more than double the sale price. This was done upon the theory that the appellants as secured creditors should have filed, in addition to the secured claims actually filed by them, "claims for priority as secured creditors" or reclamation proceedings. This is contrary to the prevailing authorities upon the question of lien rights under the Chandler Act (p. 16). The filing of a claim in bankruptcy is not essential to preserve the lien (p. 16). The Trustee takes property of bankrupt subject to all valid liens as of the date of bankruptcy (p. 17). As to conditional sales contract, trustee takes no title (p. 17). The priority provisions of the bankruptcy act have no effect upon secured claims (p. 17). The claims of the appellants were recog-

nized as valid liens and properly filed in the proceedings. Bankruptcy Act does not require additional procedure. (p. 18).

Equity will not order a sale by a Trustee in Bankruptcy free and clear of liens if it appears that the purchase price is less than the amount of the liens (p. 18). Sale must not injure lienholders and burden is on trustee to prove that property will bring more than liens (p. 19).

Lienholders are not chargeable with the expense of administration unless they consent, the administration is for their benefit, or they apply for the administration by the Court (p. 21). The lack of other assets to pay administration expenses has no bearing upon Court's decision where insufficient is realized by sale free and clear to meet liens (p. 21). This is also the rule as to expenses of operating in receivership (p. 22).

Sale of lienors' security for less than amount to pay encumbrances results in a violation of the Fifth and Fourteenth Amendments to the Constitution. (p. 23). Right to retain a lien until payment is substantial property right (p. 23). Bankruptcy does not impair liens (p. 23). Confusion in distribution would result if rule were otherwise (p. 24).

Participation in reorganization proceedings does not operate as a waiver of lien (p. 26). Intention to waive or estoppel must exist (p. 26). Permitting trustee to remain in possession does not waive claim to security (p. 27). Under Section 77B of the Bankruptcy Act before Chandler Act, estoppel analyzed in relation to cooperation with reorganization trustee (p. 27).

Conclusion (p. 28).

ARGUMENT

The Decision of the Lower Court is Contrary to the Generally Accepted and Prevailing Authorities Upon Question of Lien Rights Under the Bankruptcy Act.

I.

(a) Reclamation or claim for priority as secured creditor is not required to preserve a valid lien.

The decisions of this Court and Circuit Courts of Appeal have uniformly held that a secured creditor need not go into the bankruptcy court, but need only rely on his security if he is not interested in obtaining access to a surplus to meet a deficiency. 6 A.J. Sec. 122, p. 584. He holds the legal title either by retention under conditional sales, or by transfer as security. He may nevertheless elect to file so long as he names himself as a secured creditor or plainly evinces his intention to participate as a secured creditor to enable him to share in a surplus to meet a deficiency. *2 Remington,* 4th Ed. Sec. 910; *Elston vs. Rusch,* 250 Mich. 221, 229 N.W. 503.

Failure of the pledgee to appear and prove his claim in the bankruptcy courts forfeits only his right to participate in the distribution of the bankrupt's estate ordered by the court. *Yeatman vs. New Orleans Sav. Inst.,* 95 U.S. 764, 24 L.Ed. 589. The filing of a claim in bankruptcy is not essential to preserve the lien. In re *Joaquin Valley Packing Co.,* 295 F. 311; Certiorari denied 44; 265 U.S. 583; *Courtney vs. Fidelity Trust Co.* (C.C.A. 6) 219 F. 57; In re *Cherokee Public Service Co.,* 94 F. (2d) 53; 33 A.B.R. 400; *Thompson-Ritchie Grocery Co. vs. Cary,* 135 So. 707, 17 La. App. 270; 20 A.B.R. (N. S.) 145; *Lester vs. So Surety Co.,* 168 Ga. 307, 295 S.W.

717; In re *North Star Ice & Coal Co.,* 252 F. 301. The receiver and trustee take and hold title subject to all valid liens. And as to conditional sales contracts, the trustee takes no title. In re *Burgemeister Brewing Co.* 84 F. (2d) 388 (C.C.A. 7); In re *Lake's Laundry Inc.* 79 (2d) 326 (C.C.A. 6). Certiorari denied 296 U.S. 622, 56 S. Ct. 144, 80 L. Ed. 442; In re *Ames,* 289 F. 208 (C.C.A. 6); In re *Tyrell,* 285 F. 69 (D.C. E.D., Mich.); In re *Erco Amusement Co.,* 39 F. (2d) 613; *Smith vs. Carukin,* 259 F. 51; 44 A.B.R. 278; In re *Voight-Pros't Brewing Co.* (C.C.A. 6) 115 F. (2d) 733.

The Trustee's rights are determined as of date of filing of the petition in bankruptcy or plan of reorganization. Section 70 (a), Title 11 U.S.C.A. Sec. 110.

A careful distinction is made in the prevailing decisions between claims for priority and secured claims. Lien creditors are not affected by priority provisions of the Bankruptcy Act. (Bankruptcy Act § 64). *The City of Dallas, et al vs. Ryan, et al,* 22 A. B. R. (N.S.) 378, at 381 (C.C.A. 5), 62 F. (2d) 959; Certiorari denied 289 U. S. 742. There has been no change in the law respecting prior and secured claims.

Secured creditor has alternative of foreclosing, and filing claim for its balance or applying to bankruptcy court for method of liquidation. (Bankruptcy Act § 57e). Failing such information the court could direct proof before the referee as to value. (Bankruptcy Act § 57h).

In re Soltman, 238 F. 241, 38 A.B.R. 270.

Claims were filed in the instant case as secured by both appellants, attaching thereto their respective conditional sales contract and chattel mortgage, each containing the same language (R. 5 and 7) as follows:

> "Claimant reserves all rights and security afforded by said contract or otherwise, and does not by filing this claim waive the same."

In each instance the claim is described as a "secured claim" (paragraph 6, R. 5 and 7). The claims were recognized as such throughout the proceedings. (R. 29, 31, 34, 36, 38 and 89). It has not been argued below that appellants had elected to come in as general creditors and waive their security.

A secured creditor, as defined in the Bankruptcy Act in Section 1 (28), may have a claim allowed for the surplus over the value of the security as provided in Section 57 (e) of the Act. Section 63, relating to debts which may be proved, does not refer to secured creditors who consequently do not have provable claims. The decision of the Circuit Court of Appeals would necessitate the filing of a claim for priority, but Section 64 of the Bankruptcy Act dealing with priorities is not concerned with secured creditors. Prior to the enactment of the Chandler Act it was held that sections respecting the filing of claims referred to unsecured claims and Section 67 (d) of the act expressly excepted liens given or accepted in good faith. Section 67 (d) is amended by the Chandler Act, but this does not appear to have altered the status of a creditor holding valid security, nor do the rights of bona fide secured creditors appear to be diminished elsewhere in the act. cf. In re *Voight-Pros't Brewing Co.* (C.C.A. 6) (1940) 115 F. (2d) 773.

II.

(a) Equity Will Not Order a Sale Free and Clear of Liens If It Appears That the Purchase Price is Insufficient to Pay Off the Lien Claimants.

The ultimate private sale was in two parts. $3,800.00 for the unencumbered property (excepting a $171.00 chattel mortgage) and $23,000.00 for the encumbered

property (R. 69-71), there being due on the encumbered property as follows:

Real estate taxes (R. 44 and 90)	$ 8,812.40
Real estate mortgage, including interest (R. 22)	50,531.00
Northwestern Brewers Supply Co. with interest from July 9, 1938, (R. 4)	1,400.00
Sturdy-Bilt Equipment Corporation, with interest (R. 6)	2,018.00
Klein Filter & Mfg. Company (R. 29), probably in excess of	1,000.00
	$63,261.40

The record is absolutely barren of any request by the lienholders to the bankruptcy court for the administration of their securities. On the contrary, they objected from the start, unless it could be shown that the Trustee could reasonably obtain more under the liens. Their objections continued (R. 33, 50, 51, and 55) and were not abandoned.

The lower court, itself, in an opinion apparently inconsistent with the instant case, in the recent case of *Hoehn, et al vs. McIntosh, Trustee* (C.C.A. 6th, March 15, 1940), 42 Am. B. R. (N.S.) 475 at 482, 110 F. (2d) 199 at 202 said:

> "(2) the power will not be exercised unless it is made to appear that there is a fair prospect of the property being sold for substantially more than enough to discharge the lien or liens upon it. In re Franklin Brewing Company (C.C.A., 2nd Cir.), 41 Am. B. R. 51, 249 Fed. 333; Ray vs. Norseworthy, 23 Wall. 128, 9 U. S. 128, 137, 23 L. Ed. 116. The court must be satisfied that a sale will be to the interest of the general creditors and not injure the lien-

holders and *where a trustee files a petition to sell real estate free of liens and the lienholders join issue with him, the burden is on him to make it appear that there is a reasonable probability the property will bring more than the amount of the liens.*" (Italics ours)

To the same effect, *Tawney vs. Clemson, Trustee* (C.C.A. 4th), 30 Am. B. R. (N.S.) 249, 81 F. (2d) 300 at 304, wherein it was said:

"The power of course should not be exercised unless it is reasonably clear that the property is worth more than the encumbrances and expenses of sale."

See *Seaboard National Bank vs. Rogers Milk Products Co., Inc., et al* (C.C.A. 2d), 21 F. (2d) 414;

Re Hagin (D.C.) 21 F. (2d) 439;

Hardrostle vs. National Clothing Co., 191 S. W. 524.

In *Louisville Joint Stock Land Bank vs. Radford,* 295 U. S. 555 at 583, 79 L. Ed. 1593 at 1601, 97 A. L. R. 1106 at 1113, it is said:

"But there had been no suggestion that a sale could be made to the prejudice of the lienor, in the interest of either the debtor or of other creditors. By the settled practice, a sale free of liens will not be ordered by the bankrupt court if it appears that the amount of the encumbrance exceeds the value of the property."

See also *Re Feeney Tool Co.,* 300 F. 379, 4 Am. B. R. (N.S. 827). And it was held that the chattel mortgagee should be left free to pursue his remedy upon the chattel mortgage in the state court.

To the same effect, *Re Fayetteville Wagon-Wood and Lumber Co.,* 197 F. 180, 28 Am. B. R. 307; 6 Am. Jur. 757 and 758.

Lienholders are not chargeable even with costs of sale or general administration unless (a) They expressly consent; (b) It be wholly to their benefit; (c) They call upon the instrumentality of the court to administer for them.

The appellant lienholders neither consented to the sale nor was the sale to their benefit, because it took away their property and prevented them from pursuing their own remedies separately, nor did they anywhere petition or call on the court to administer their security.

It was said in *Seaboard National Bank vs. Rogers Milk Products Co., Inc., et al* (C.C.A. 2d), 21 F. (2d) 414 at 417:

> "There is doubt whether even the expenses of the sale should be charged to the lienor if he did not consent to the sale. Aetna Life Ins. Co. vs. Leonard, supra; In re Vulcan Foundry, etc., Co., 180 F. 671 (C.C.A. 3). Nor is it material that no general estate remains to compensate the receiver or the trustee in bankruptcy, or their attorneys, where the fund realized is less than the amount of the valid incumbrance. In re Williams, supra; Smith vs. Township of Au. Gres, 150 F. 257, 9 L. R. A. (N.S.) (C.C.A. 6); In re Cutler & John (D.C.), 228 F. 771 (E.D.N.C.). This is no hardship, for the sale should not have been asked unless there was a reasonable expectation that the general estate would be benefited."

The liens must be paid out first. The lienholders cannot be charged with expenses without their request or consent. *Annotations,* 75 L. Ed. 658. See *Byrer vs. Bushong* (C.C.A. 4th), 42 Am. B. R. (N.S.) 14, 108 F. (2d) 594. In *re Rubin L. Meyers, supra* (C.C.A. 2d), 24 F. (2d) 349, 11 Am. B. R. (N.S.) 568. *Tawney vs. Clemson, Trustee* (C.C.A. 4th), 81 F. (2d) 300.

It was said in *Bruce Sewing Machine Company,* District Ct. (S.D. Ill.), 2 F. Supp. 330, 22 Am. B.R. (N. S.) 446 at 451:

> "Under these circumstances the only deductions that can be made from the purchase price are the costs which would have accrued in foreclosing the mortgage in the Circuit Court of Sangamon County. Had the bank abandoned the remedy which it had selected, and sought the foreclosure of its mortgage through the proceedings in bankruptcy to sell the mortgaged property, free and clear of all encumbrances, or if the proceeding was entirely for the benefit of the bank, then a different situation might have been created. But, where the holder of a valid lien upon real estate owned by the bankrupt is forced to permit his security to be sold, free and clear of all incumbrances, the fund so created may not be diminished by the costs of administration in a bankruptcy proceeding. To hold otherwise would nullify the security granted by Congress in the enactment of the Bankruptcy Act, to the holders of valid liens upon the property of persons who became insolvent."

This also has been the holding as to expenses of operating the business in receivership although lienor may bear the reasonable expense of preserving the pledged property. *Miners Savings Bank of Pittston, Pa., et al vs. P. F. Joyce, et al, Trustee* (C.C.A. 3), 37 Am. B.R. (N.S.) 400, 97 F. (2d) 973; *Byrer vs. Bushong, supra* (C.C.A. 4), 42 Am. B.R. (N.S.) 14, 108 F. (2d) 594.

(b) The Procedure Adopted by the Trustee Here Would Result in a Violation of the Constitutional Protection Afforded by the Fifth and Fourteenth Amendments, in Abrogating Vested Contract Rights, Result in a Deprivation of the Property of the Appellants, Injustice, and a Vortex of Confused Questions Relating to Distribution.

Distribution of the proceeds of this sale is practically impossible because after deducting the expenses there will be left little or nothing. An affirmance here will produce added litigation over a fund admittedly insufficient even though creditors prevail in their effort to surcharge the trustees' account.

This sale results in a deprivation of property contrary to the Fifth and Fourteenth Amendments to the U. S. Constitution.

> "It is a shocking result, and such as justly brings receiverships into disrepute in the popular mind." *Seaboard National Bank vs. Rogers Milk Products Co. et al* (C.C.A. 2), 21 F. (2d) 414, 416.
>
> "The right to retain a lien until the debt secured thereby is paid is a substantial property right which may not be taken from the creditor consistently with the Fifth and Fourteenth Amendment to the Constitution. Louisville Joint State Bank vs. Redford, 295 U.S. 555, 594, 79 L. Ed. 1593, 55 S. Ct. 854, 97 A.L.R. 1106, 28 A.B.R. (N.S.) 397 * * * " *Security-First Nat. Bank vs. Rindge Land & Nav. Co.* (C. C. A. 2) 85 F. 2d 557, 107 A.L.R. 1240, 32 A.B.R. (N.S.) 97, writ of certiorari denied in 299 U.S. 613.

Liens may not be impaired in bankruptcy so as to abrogate existing contractual rights. *Duparquet Huot & Monuse Co. vs. Evans,* 56 S. Ct. 412, at 415, 297 U.S. 216, 80 L. Ed. 591 per Justice Cardozo:

> " * * * it is also common learning that not even a trustee in bankruptcy may override a valid mortgage

lien [Seven cases cited] * * * Section 77B (11 U.S. C.A. 207) does not make these precedents inapposite * * *. Only by excluding a receiver in foreclosure from the scope of subdivision (i) [supplanting other possession] can we avoid anomalous encroachments upon vested rights and interests" (Brackets by briefer).

cf. *In re Forty-One Thirty-Six Wilcox Bldg. Corp.* (C.C.A. 7) 100 F. (2d) 588.

These fundamental principles are assuredly equally applicable whether the security be realty or personalty. By confirmation of the proposed sale the court would render ineffectual the well established right to secure an obligation as against all other claimants.

We have attempted to approach this matter from the standpoint of showing the injustice created by the affirmance of the order of the lower court confirming the sale. We are constrained however to point out to the court the vortex of legal questions that arise upon such confirmation. In the event this Court denies the writ requested, the difficulty of determination of apportionment of the proceeds of the sale arises. It should be borne in mind that a trustee's liability may be established if this sale is confirmed for incurring expenses unauthorized in law and unwarranted by a situation apparent to him, but which could not have been apparent to the claimants. Unauthorized loans or disbursements cannot be given priority as administration expenses. *Matter of Avorn Dress Co.* (C.C.A. 2), 79 F. (2d) 337, 29 A.B.R. (N. S.) 497.

Confirmation of the sale leaves the question of distribution in utter confusion. Would the property be subjected to the cost of maintenance in reorganization where it was recognized as a proper secured claim? Or the loss by

trustee's operation in that proceeding? Or for attorney and trustee's fees in that proceeding? Or for wage claims due from the trustee?

Should claimants' property be applied to the cost of maintenance in the bankruptcy proper, to attorneys' and trustees' fees there? or to the cost of a sale which would in effect confiscate the property?

It would certainly create the anomaly and foster the encroachments decried by the Supreme Court in the *Duparquet* case, supra, and *Miners' Savings Bank Pittston, Pa. vs. Joyce,* 97 F. (2d) 973.

That lienors do not come within distribution under provisions of Section 64 of the Bankruptcy Act is also plain from the decisions that they do not have to contribute to the costs of the bankruptcy, which are the first items to be paid on a distribution under Section 64, unless the lienor has invoked the aid of the court, nor then except as to direct and necessary expense of preserving and realizing on his security. *Gugel vs. New Orleans Bank* (C.C.A. 5th), 39 A.B.R. 160, 239 F. 676; *In re Williams* (C.C.A. 9th), 19 A.B.R. 389, 156 F. 934; *In re Cutler and John* (D.C.), 36 A.B.R. 420, 228 F. 771. See also *In re Vulcan Foundry, etc.* (C.C.A. Pa.), 180 F. 671, 24 A.B.R. 825, and *In re Harralson* (C.C.A. 8th), 179 F. 490, 29 L.R.A. (N.S.) 737, 24 A.B.R. 715; *Robertson vs. Goree* (C.C.A. 5th), 29 F. (2d) 261, 13 A.B.R. (N.S.) 64. *Louisville Joint Stock Land Bank vs. Radford,* 295 U.S. 555, 583, 79 L. Ed. 1593, 1601, 97 A.L.R. 1106, 1113.

III.

Participation in Reorganization Proceedings Does Not Operate as a Waiver of Lien or an Estoppel.

The only other conclusion that might be drawn from the Court's Order of Affirmance is that there is present either a waiver or an estoppel.

There is no waiver because as shown above, it was not necessary to come into court with a claim.

Ward vs. First National Bank (C.C.A. 6), 202 F. 612, 29 A.B.R. 312;

In re Hagin, 21 F. (2d) 434, 10 A.B.R. (N.S.) 523.

In *Maxwell vs. McDaniels,* 195 F. 426, 428, 429, it was said:

> "Acts relied on as a waiver or a release must either be done with intent to waive or release or else they must be such as might reasonably have led, and in point of fact did lead, other persons to act to their hurt upon the assumption that the waiver or release had been made."

The reorganization receiver and trustee in bankruptcy both knew with absolute certainty that no waiver or release existed and they incurred no deficit because of the appellants. The change of position if it can be called that, resulting from the ill-advised running the business at a loss during reorganization, was certainly not the result of appellants' acts, or failure to reclaim.

Numerous cases can be supplied as authority that permitting the trustee to remain in possession does not waive the lien claimed as security. Among these are:

In re Endlar, 192 F. 762, 113 C.C.A. 48;

Gadd vs. Dawson, 291 F. 327;

Smith vs. Township of Au Gres, Mich., 150 F. 257, 80 C.C.A. 145, 9 L.R.A. (N.S.) 876;

In re Collinwood Motor Sales, 72 F. (2d) 137;

Hamilton Nat. Bank vs. McCollum, 58 F. (2d) 912;

In re Aldoy Motor Co., 50 F. (2d) 221, and certiorari denied;

Scott vs. Hamilton Nat. Bank, 53 S. Ct. 19, 287 U. S. 619, 77 L. Ed. 537.

This remained the rule under § 77B where the receiver took possession. *Duparquet Huot & Monuse Co. v. Evans,* 56 S. Ct. 412, 297 U. S. 216, 80 L. Ed. 591. A well reasoned case from the Tenth Circuit which is contrary in effect to the decision of the lower court is the case of *Coursey vs. International Harvester Co.,* 109 F. (2d) 774, which subordinated expenses to liens in reorganization and said:

"As to the question of waiver of their lien, an estoppel is an indispensable element of a waiver. Lewin v. Telluride Iron Works Co. et al. (C.C.A., 8th Cir.), 47 Am. B. R. 22, 272 Fed. 590, and authorities therein cited.

"Elements of an estoppel are (1) ignorance on part of the parties who invoke the estoppel or him from whom such parties derive such claim, (2) a representation by word or act by party estopped which has misled, and (3) an innocent and detrimental change of the party asserting the estoppel in reliance upon the representation. Northern Assurance Co. v. Grand View Bldg. Co. (C. C. A., 8th Cir.), 101 Fed. 77.

"Not existing in this case are (1) ignorance of the parties who invoke the estoppel or him from which such partes derive such claim, (2) a representation by word or act by party alleged to be estopped which has misled, and (3) an innocent and detrimental

change on part of the party asserting the estoppel in reliance upon the representation."

In this connection it should again be noted that there was no compliance with the provisions of Chapter X, § 116(2) permitting receiver or trustee to issue certificates having priority over lien claims. Since notice and order under that section do not exist the effect of the decision of the Circuit Court of Appeal in the instant case is to accomplish a similar result without statutory authority. Under the decisions of this court and of other circuits this should not be done.

CONCLUSION

The Circuit Court of Appeals has decided an important question of law, concerning the rights of secured creditors in bankruptcy, in conflict with the decisions of other circuit courts of appeal and of this Court, and in probable conflict with its own decisions.

It is respectfully submitted that this Court should grant a writ of certiorari for the reason that the order of the Circuit Court of Appeals.

(a) Is contrary to the established law as determined in this Court and other Circuit Courts of Appeals as to secured claims in bankruptcy; and

(b) Is contrary to the decisions of this Court and other Circuit Courts of Appeals relative to sales by Trustees in Bankruptcy of property subject to valid liens; and

(c) That, if said decision has been reached by reason of Chapter X of the Chandler Act, it resolves an unsettled question contrary to the de-

cisions of parallel courts prior to passage of that amendment to the bankruptcy act.

The case concerns a matter of everyday business life that should not be left in doubt.

Respectfully submitted,

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